No. 15755

In the United States Court of Appeals for the Ninth Circuit

MERRIMAN H. HOLTZ AND HELEN TYROLL HOLTZ,
PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

On Petition for Review of the Decision of the Tax Court of the United States

BRIEF FOR THE RESPONDENT

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INDEX

CITATIONS

Cases:

Cases—Continued Page

Statute:

Miscellaneous:

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OPINION BELOW

The memorandum opinion of the Tax Court (R. 26-34) is not officially reported.

JURISDICTION

This petition for review (R. 34-36) involves deficiencies in federal income taxes for the calendar years 1949 and 1950 in the respective amounts of $958.30 and $671.66 (R. 26). A notice of deficiency was mailed to the taxpayers on March 14, 1955. (R. 5, 10-15.) On June 13, 1955, the taxpayers filed a petition for redetermination of these deficiencies under the provisions of Section 272(a) of the In-

ternal Revenue Code of 1939. (R. 3, 5-10.) The decision of the Tax Court was entered on June 26, 1957. (R. 4, 25.) The case is brought to this Court by a petition for review filed by the taxpayers [1] on September 17, 1957. (R. 4, 34-39.) Jurisdiction is conferred on this Court by Section 7482 of the Internal Revenue Code of 1954.

QUESTION PRESENTED

Whether the Tax Court erred in determining that a loss resulting from the taxpayer's guaranty of loans made to a corporation of which he was the controlling stockholder was deductible by him as a nonbusiness bad debt under Section 23(k)(4) of the Internal Revenue Code of 1939, rather than as a business bad debt under Section 23(k)(1).

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * *

(k) [As amended by Sec. 124(a), Revenue Act of 1942, c. 619, 56 Stat. 798, and Sec. 113 (a), Revenue Act of 1943, c. 63, 58 Stat. 21] *Bad Debts.*—

(1) *General rule.*—Debts which become worthless within the taxable year; or (in

[1] Since Helen Tyroll Holtz, the wife of Merriman H. Holtz, is involved solely because of the filing of joint tax returns for the taxable years (R. 18), her husband hereinafter will be referred to, individually, as the taxpayer.

the discretion of the Commissioner) a reasonable addition to a reserve for bad debts; and when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt, in an amount not in excess of the part charged off within the taxable year, as a deduction. This paragraph shall not apply in the case of a taxpayer, other than a bank, as defined in section 104, with respect to a debt evidenced by a security as defined in paragraph (3) of this subsection. This paragraph shall not apply in the case of a taxpayer, other than a corporation, with respect to a non-business debt, as defined in paragraph (4) of this subsection.

* * * *

(4) *Non-business debts.*—In the case of a taxpayer, other than a corporation, if a non-business debt becomes worthless within the taxable year, the loss resulting therefrom shall be considered a loss from the sale or exchange, during the taxable year, of a capital asset held for not more than 6 months. The term "non-business debt" means a debt other than a debt evidenced by a security as defined in paragraph (3) and other than a debt the loss from the worthlessness of which is incurred in the taxpayer's trade or business.

* * * *

(26 U.S.C. 1952 ed., Sec. 23.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

SEC. 29.23(k)-6 [As amended by T. D. 5458, 1945 Cum. Bull. 45]. *Non-Business Bad Debts.*

—In the case of a taxpayer, other than a corporation, if a non-business bad debt becomes entirely worthless within a taxable year beginning after December 31, 1942, the loss resulting therefrom shall be treated as a loss from the sale or exchange of a capital asset held for not more than six months. Such a loss is subject to the limitations provided in section 117 with respect to gains and losses from the sale and exchange of capital assets. A loss with respect to such a debt will be treated as sustained only if and when the debt has become totally worthless, and no deduction shall be allowed for a non-business debt which is recoverable in part during the taxable year. Nor are the provisions of this subdivision applicable in the case of a loss resulting from a security as defined in section 23(k)(3). A non-business debt is a debt, other than a debt the loss from the worthlessness of which is incurred in the taxpayer's trade or business and other than a debt evidenced by a security as that term is defined in section 23(k)(3). The question whether a debt is one the loss from the worthlessness of which is incurred in the taxpayer's trade or business is a question of fact in each particular case. The determination of this question is substantially the same as that which is made for the purpose of ascertaining whether a loss from the type of transaction covered by section 23(e) is "incurred in trade or business" under paragraph (1) of that section.

The character of the debt for this purpose is not controlled by the circumstances attending its creation or its subsequent acquisition by the taxpayer or by the use to which the borrowed funds

are put by the recipient, but is to be determined rather by the relation which the loss resulting from the debt's becoming worthless bears to the trade or business of the taxpayer. If that relation is a proximate one in the conduct of the trade or business in which the taxpayer is engaged at the time the debt becomes worthless, the debt is not a non-business debt for the purposes of this section.

* * * *

STATEMENT

The facts as stipulated (R. 18-24) and as found by the Tax Court (R. 26-34) may be summarized as follows:

The taxpayer and his wife, residing in Portland, Oregon, filed their joint income tax returns for 1949 and 1950 with the then Collector of Internal Revenue for the District of Oregon at Portland, Oregon. (R. 26.)

The taxpayer has been engaged since 1930 in the business of selling and distributing 16 millimeter film, audio visual equipment, supplies and accessories. (R. 26-27.)

In 1930 the taxpayer organized Pictures, Inc., under the laws of the State of Oregon. Pictures, Inc., was inactive until 1949 when it began the sale and distribution of 16 millimeter films in the Territory of Alaska. The corporation has continued in operation since 1949. The taxpayer was the manager of Pictures, Inc., and advanced to it the funds required for its operation. During 1949 and 1950 the taxpayer owned 99 of the 100 outstanding shares of capital stock of the corporation. (R. 27.)

During 1932 the taxpayer organized Screen Adettes, Inc., pursuant to the laws of the State of Oregon. Since the time of its organization, Screen Adettes, Inc., has been engaged in the sale and distribution of 16 millimeter films in Oregon. During 1949 and 1950 the taxpayer owned 91 of 100 shares of outstanding capital stock of Screen Adettes, Inc. The taxpayer occasionally made advances to this corporation for working capital. In addition, Screen Adettes, Inc., on several occasions borrowed money from the United States National Bank of Portland, Oregon. All such loans were personally guaranteed by the taxpayer, who was president and managing officer of Screen Adettes, Inc., and was actively engaged in its affairs. (R. 27.)

In 1945 the taxpayer organized Screen Adette Equipment Corporation, under the laws of Oregon, for the purpose of engaging in the sale and distribution of motion picture equipment and accessories on the Pacific coast. He was the owner of 500 of 503 shares of its outstanding stock. The taxpayer was president and general manager of the corporation and was actively engaged in conducting its operations. In addition to the original capital invested by the taxpayer, Screen Adette Equipment Corporation obtained working capital from the United States National Bank of Portland, Oregon. The amounts so obtained were in the form of loans which were personally guaranteed by the taxpayer, who pledged as collateral certain shares of listed common stock owned by him. (R. 27-28.) The funds were needed to assist the corporation in its business. (R. 19.)

At the time the foregoing shares were pledged by the taxpayer, they had a market value substantially in excess of the value of the loans. (R. 28.)

In October, 1949, Screen Adette Equipment Corporation filed a voluntary petition in bankruptcy with the United States District Court for the District of Oregon. The corporation thereafter ceased its operations and was dissolved by proclamation of the Governor of the State of Oregon on December 29, 1950. Pursuant to the bankruptcy proceeding, creditors of Screen Adette Equipment Corporation received only 0.038% upon the claims filed by them. (R. 28.)

In January and March of 1950 the United States National Bank of Portland sold the collateral securities pledged by the taxpayer as guarantor for the indebtedness of Screen Adette Equipment Corporation. The bank realized $83,316.29 from the sale of the securities which amount was applied against the indebtedness of the corporation. Consequently, the taxpayer was indebted to the bank in the amount of $64,119.34 upon his guaranty. (R. 28-29.)

The taxpayer was engaged as a sole proprietor in the sale and distribution of audio visual equipment during part of 1950. In addition, during 1950 he was employed on a part-time basis to sell 16 millimeter films for Audio Film Center, an association which operated a film rental library in Portland, Oregon. (R. 29.)

The taxpayer was the owner of 90% of the outstanding capital stock of Helene's, Inc., for many years prior to 1949. Helene's, Inc., was a corpora-

tion engaged in the operation of a ladies' retail apparel store in Portland, Oregon. The taxpayer was president and was active in the management of Helene's, Inc. After moving to a new location in 1947, Helene's, Inc., experienced substantial losses, and in 1949 all of its assets were sold. Creditors of Helene's, Inc., received approximately 50% of their claims in full settlement. (R. 29.)

During the years of its operation prior to 1949, Helene's, Inc., had borrowed various amounts from the United States National Bank of Portland for use as working capital. Such loans were guaranteed by the taxpayer who pledged as collateral certain listed common stocks and life insurance policies owned by him. (R. 29.)

The taxpayer and his wife claimed a deduction in the amount of $83,316.29 on their joint income tax return for 1950 as "Bad debts arising from sales or services." This deduction was explained in Schedule C-2 of their 1950 return as "Payments made to U. S. National Bank as guarantor of business debt." The foregoing deduction represented payments made by the taxpayer in January and March of 1950 as guarantor on the notes of Screen Adette Equipment Corporation. (R. 29-30.)

The Tax Court found as a fact that the indebtedness in question did not bear a proximate relationship to the taxpayer's trade or business, either at the time the loan was made or at the time it became worthless, and that, therefore, the losses in issue must be treated as nonbusiness bad debts under Section 23(k)(4) of the 1939 Code. (R. 34.)

SUMMARY OF ARGUMENT

Section 23(k) of the Internal Revenue Code of 1939 authorizes the deduction in full of business bad debt losses, but provides for only limited deductibility of nonbusiness bad debts. The statute defines a nonbusiness bad debt as a debt other than one the loss from the worthlessness of which is incurred in a taxpayer's trade or business. Whether the loss is incurred in the taxpayer's business presents a question of fact for the trial court, whose determination may not be disturbed unless clearly erroneous.

The indebtedness in question was one on a guaranty executed by the taxpayer in order to accommodate a corporation of which he was controlling stockholder, officer and employee. The guaranty was given to help the corporation in its business. It is uniformly held that in this type of case it is only where the taxpayer-stockholder is individually engaged in the business of promoting, financing and managing business enterprises, that he can deduct losses resulting from loans made to his corporation (directly or as guarantor) as business bad debts.

The taxpayer did not claim in the trial court, nor does he claim in this Court, that he was in the business of guaranteeing loans, and the promotional or organizational activity in which he engaged falls far short of amounting to the carrying on of the business of promoting, financing and managing business enterprises. Although the taxpayer in several instances made use of the corporate form of doing business, it is settled law that the business of a corporation is not the business of its stockholders, officers or em-

ployees. Though the loss was proximate to the business of a corporation controlled by the taxpayer, the taxpayer may not treat the corporation's business as his own for purposes of claiming a business bad debt deduction.

The Tax Court was, therefore, clearly justified in finding that the indebtedness in question was not incurred in the prosecution of an individual business of the taxpayer, either at the time it was incurred or at the time it became worthless, and that the taxpayer is entitled only to a nonbusiness bad debt loss deduction. The taxpayer points to no authority which calls for reversal of the decision below.

ARGUMENT

The Tax Court Applied the Correct Principles of Law, and Its Finding That the Claimed Bad Debt Losses Were Not Incurred In the Individual Trade or Business of the Taxpayer Is Supported By the Evidence and Not Clearly Erroneous

A. *Issue presented and controlling principles*

1. *Issue presented*

Section 23(k)(1) of the Internal Revenue Code of 1939, *supra*, authorizes the deduction in full of that part of a debt which becomes worthless during the taxable year, but excepts therefrom nonbusiness debts of noncorporate taxpayers; and Section 23(k)(4) allows a deduction for a nonbusiness debt when the debt becomes worthless in the taxable year, limiting the deduction to a short-term capital loss deduction. Section 117(d)(2) of the 1939 Code, as amended by Section 150(c) of the Revenue Act of

1942, c. 619, 56 Stat. 798 (26 U.S.C. 1952 ed., Sec. 117), provides that in the case of a taxpayer, other than a corporation, losses from sales or exchanges of capital assets shall be allowed only to the extent of the gains from such sales or exchanges, plus the net income of the taxpayer or $1,000, whichever is smaller.

In this case the taxpayer contends that he is entitled to a business bad debt loss deduction under Section 23(k)(1) of the 1939 Code. The loss was due to a guaranty executed by the taxpayer on behalf of his wholly-owned corporation; however, since the Supreme Court classifies such transactions for the purpose of Section 23(k) as loans, in this brief we sometimes refer to the transaction here in question as a loan. *Putnam* v. *Commissioner*, 352 U. S. 82.

In determining whether a debt is business or nonbusiness, the inquiry is whether the loss was incurred in the conduct of a trade or business in which the taxpayer was individually engaged at the time the debt became worthless. *Skarda* v. *Commissioner* (C.A. 10th), decided November 30, 1957 (58-1 U.S.T.C., par. 9142); *Pokress* v. *Commissioner*, 234 F. 2d 146 (C.A. 5th); *Hickerson* v. *Commissioner*, decided December 29, 1954 (1954 P-H T. C. Memorandum Decisions, par. 54,343), affirmed, 229 F. 2d 631 (C.A. 2d); *Van Pelt* v. *Commissioner*, decided August 10, 1950 (1950 P-H T. C. Memorandum Decisions, par. 50,193), affirmed *per curiam*, 191 F. 2d 861 (C.A. 6th); Section 29.23(k)-6, Treasury Regulations 111, *supra*. The question is one of pure fact

for the trial court and, therefore, the inquiry on appeal is whether that court's finding is clearly erroneous. *Maloney* v. *Spencer*, 172 F. 2d 638, 640 (C.A. 9th); *Gulledge* v. *Commissioner*, 249 F. 2d 225, 227 (C.A. 4th); *Wheeler* v. *Commissioner*, 241 F. 2d 883 (C.A. 2d); *Giblin* v. *Commissioner*, 227 F. 2d 692 (C.A. 5th); *Nicholson* v. *Commissioner*, 218 F. 2d 240 (C.A. 10th); *Skarda* v. *Commissioner*, *supra*; *Pokress v. Commissioner*, *supra*, p. 150; *Sogg* v. *Commissioner*, decided October 4, 1950 (1950 P-H T. C. Memorandum Decisions, par. 50,251), affirmed *per curiam*, 194 F. 2d 540 (C.A. 6th); S. Rep. No. 1631, 77th Cong., 2d Sess., p. 90 (1942-2 Cum. Bull. 504, 573).

The Tax Court in this case found (R. 34) that the indebtedness in question was not incurred in the prosecution of an individual business of the taxpayer, either at the time the loan was made or at the time it became worthless, and, accordingly, allowed only a nonbusiness bad debt deduction for the losses in question. If that court applied the correct principles of law, the only issue is a factual one—whether the present record is such that the Tax Court was compelled, as a matter of law, to find for the taxpayer.

2. *The controlling principles*

The principle is well settled, and is of general application in tax controversies, that corporations are entities separate and apart from their owners, having their own business, and their owners may not treat that business as their own in order to realize tax benefits. *Burnet* v. *Commonwealth Imp. Co.*, 287

U. S. 415, 419; *Burnet* v. *Clark*, 287 U. S. 410, 415; *Dalton* v. *Bowers*, 287 U. S. 404, 410; *Brinker* v. *United States*, 116 F. Supp. 294, 298 (N.D. Cal.), affirmed *per curiam*, 221 F. 2d 478 (C.A. 9th); *Commissioner* v. *Schaefer*, 240 F. 2d 381, 383 (C.A. 2d). When, therefore, a corporation sustains losses, or when, as in this case, its stockholder guarantees its debts or advances funds to it and a loss is incurred, that loss is directly related to, and a result of, the corporation's trade or business (*Wheeler* v. *Commissioner*, decided May 27, 1955 (1955 P-H T. C. Memorandum Decisions, par. 55,138), affirmed, 241 F. 2d 883 (C.A. 2d); *Commissioner* v. *Schaefer*, *supra*, p. 383; *Van Dyke* v. *Commissioner*, 23 B.T.A. 946, affirmed *per curiam*, 63 F. 2d 1020 (C.A. 9th), affirmed *per curiam*, 291 U. S. 642, rehearing denied, 291 U. S. 650), and it is the corporation which, under the taxing statute, is entitled to deduct the funds thus lost as business-loss deductions. *Gulledge* v. *Commissioner*, 249 F. 2d 225 (C.A. 4th).

Since, in order to take a business bad debt deduction a taxpayer must have sustained the loss in a trade or business of his own, and since the business of a corporation is not that of its stockholders, the general rule is that when a taxpayer chooses the corporate method for ownership and conduct of his business he may not, when it comes to determining his tax obligations, treat the promotion and financing of the business as his personal business. This is so whether he carries on such activity through one corporation or several corporations. *Burnet* v. *Clark*, *supra*; *Dalton* v. *Bowers*, *supra*; *Van Dyke* v. *Com-*

missioner, supra; Towers v. *Commissioner*, 24 T. C. 199, affirmed, 247 F. 2d 233 (C.A. 2d), certiorari denied, January 6, 1958; *Commissioner* v. *Schaefer, supra; Hickerson* v. *Commissioner*, decided December 29, 1954 (1954 P-H T. C. Memorandum Decisions, par. 54,343), affirmed, 229 F. 2d 631 (C.A. 2d); *Nicholson* v. *Commissioner*, 218 F. 2d 240 (C.A. 10th); *Berwind* v. *Commissioner*, 20 T. C. 808, affirmed *per curiam*, 211 F. 2d 575 (C.A. 3d); *Commissioner* v. *Smith*, 203 F. 2d 310 (C.A. 2d), certiorari denied, 346 U. S. 816. And, if such taxpayer devotes a substantial length of time as an officer and manager of his corporations, as is the usual case, it may be that he is personally in a business of sorts; but loans to a corporation by an officer or manager thereof are no part of the business of being an employee. *Commissioner* v. *Schaefer, supra; Hickerson* v. *Commissioner, supra; Nicholson* v. *Commissioner, supra; Berwind* v. *Commissioner, supra; Commissioner* v. *Smith, supra; Van Pelt* v. *Commissioner*, decided August 10, 1950 (1950 P-H T. C. Memorandum Decisions, par. 50,193), affirmed *per curiam*, 191 F. 2d 861 (C.A. 6th); *Park* v. *Commissioner*, 22 B.T.A. 1263, affirmed *sub nom. In re Park's Estate*, 58 F. 2d 965 (C.A. 2d), certiorari denied, 287 U. S. 645; *Boissevain* v. *Commissioner*, 17 T. C. 325.

To take a transaction out of the general rule the taxpayer has the burden of showing that the corporation to which the loan in issue was made was merely a part of a complete, comprehensive business of promoting, organizing and managing business enterprises (a rule applied by decisions commonly re-

ferred to as the "promoter" cases) in the year in which the loss was incurred, and that the loss was sustained in the carrying on of that business.[2] *Brinker* v. *United States*, 116 F. Supp. 294 (N.D.Cal.), affirmed *per curiam*, 221 F. 2d 478 (C.A. 9th); *Skarda* v. *Commissioner* (C.A. 10th), decided November 30, 1957 (58-1. U.S.T.C., par. 9142); *Wheeler* v. *Commissioner*, decided May 27, 1955 (1955 P-H T. C. Memorandum Decisions, par. 55,138), affirmed, 241 F. 2d 883 (C.A. 2d); *Giblin* v. *Commissioner*, 227 F. 2d 692 (C.A. 5th); *Boissevain* v. *Commissioner*, *supra; Campbell* v. *Commissioner*, 11 T. C. 510.

Applying the principles just discussed, the Tax Court in this case found (R. 33) that the taxpayer's activities in connection with three corporations disclosed no more than the customary activities of an individual who devotes himself to carrying on a business enterprise by means of wholly-owned corporations—that the taxpayer was not in a separate business of promoting, organizing, financing and managing business enterprises before or during 1950, the year of the loss.

The taxpayer contends (Br. 7-11), however, that Congress intended that any taxpayer who carries on business through corporations is entitled to business

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[2] Of course, if the taxpayer claims and proves that he was regularly and continuously engaged in the business of loaning money or, if a guaranty is in question, in the business of a guarantor, he may also show the loss was incurred in such a business. There was no contention below, nor is there in this Court, that the taxpayer was in any one of those businesses, and the record would not support such a contention.

bad debt deductions for advances to the corporations that subsequently become worthless. By giving undue emphasis to an incidental observation found in a House Ways and Means Commitee Report (Br. 8), the taxpayer states that the law discussed, *supra*, is error for, if loans are not made to a friend or relative without expectation of repayment,[3] it necessarily follows that they should be treated as business bad debts. This argument is without merit. Aside from the fact that this contention is contrary to all the cases cited, *supra*, the Supreme Court specifically over-ruled such contention in *Putnam* v. *Commissioner*, 352 U. S. 82, 91, fn. 17. Moreover, the Committee Reports of Congress specifically provide that a business bad debt deduction is allowable only where the loss is incurred in an individual trade or business in which the taxpayer is engaged at the time of the loss. H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 76-77 (1942-2 Cum. Bull. 372, 431); S. Rep. No. 1631, 77th Cong., 2d Sess., p. 90 (1942-2 Cum. Bull. 504, 573).

B. *The record furnishes clear support for the Tax Court's findings, which are not clearly erroneous*

The taxpayer, in his second point, argues (Br. 6-7, 12-22) that if the Tax Court applied the correct

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[3] It may be well to point out that if money is loaned without expectation of repayment no bad debt deduction can be taken—business or nonbusiness. *Hoyt* v. *Commissioner*, 145 F. 2d 634 (C.A.2d); *W. F. Young, Inc.* v. *Commissioner*, 120 F. 2d 159 (C.A.1st); *Thompson* v. *Commissioner*, 22 T. C. 507.

principles, he was, in any event, a "promoter", although he readily concedes that the record shows merely that he was carrying on business through several wholly-owned corporations (Br. 10-11, 19). His argument runs squarely counter to the settled general rule that if a taxpayer chooses to carry on business by means of controlled corporations, the business of the corporations is not his business, and loans made to those corporations, which subsequently become worthless, are not business bad debts.[4] Such taxpayer, in contemplation of tax law, loans or advances money as a stockholder, officer, and investor interested in advancing the business of his corporation.[5] *Burnet* v. *Clark*, 287 U. S. 410; *Dalton* v. *Bowers*, 287 U. S. 404; *Towers* v. *Commissioner*, 24 T. C. 199, affirmed, 247 F. 2d 233 (C.A. 2d), certiorari denied, January 6, 1958; *Wheeler* v. *Commissioner*, *supra*. Hence, as the taxpayer recognizes (Br. 19), the cases that allow business bad debt loss deductions under the "promoter" principle require a clear showing, as their mainstay, of continuous promotional activity in organizing many corporations, and the activity must be prosecuted with such regularity as to amount to the carrying on of a business. *Giblin* v. *Commis-*

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[4] This principle is referred to, for the sake of simplicity, as "the general rule".

[5] The taxpayer's incidental suggestion (Br. 21-22) that during 1930 to 1950 he was in the trade of leasing and selling picture equipment is without merit—this business was that of Screen Addette Equipment Corporation, a separate and distinct entity from the individual who controlled it.

sioner, 227 F. 2d 692 (C.A. 5th); *Washburn* v. *Commissioner*, 51 F. 2d 949 (C.A. 8th); *Campbell* v. *Commissioner*, 11 T. C. 510. Cf. *Towers* v. *Commissioner*, *supra*; *Hickerson* v. *Commissioner*, 229 F. 2d 631, 634 (C.A. 2d); *Fuller* v. *Commissioner*, 21 T. C. 407, 412; *Reilly* v. *Commissioner*, decided January 20, 1955 (1955 P-H T.C. Memorandum Decisions, par. 55,007); *Cochran* v. *Commissioner*, decided March 21, 1955 (1955 P-H T. C. Memorandum Decisions, par. 55,066); *Boissevain* v. *Commissioner*, 17 T. C. 325, 333.

The cases upon which the taxpayer relies are readily distinguishable on their facts. If any comparison is to be made with other cases, then we submit that the instant case bears a closer resemblance to the many in which the trial courts' disallowance of the claimed deduction has been sustained on appeal than to the isolated few mentioned by the taxpayer.

In *Giblin* v. *Commissioner*, 227 F. 2d 692 (C.A. 5th), the taxpayer promoted or organized twelve business enterprises. In *Washburn* v. *Commissioner*, *supra*, the taxpayer promoted or organized eleven corporations. In *Campbell* v. *Commissioner*, *supra*, the taxpayer promoted or organized twelve corporations. In each of those cases the promoting activities were continuous and regular and the taxpayer spent his time managing and financing the various business enterprises. In each case it was determined that the corporations to which loans were made were a part of a separate business of the taxpayer—the business of promoting, financing and managing—and

business bad debt loss deductions were allowed.[6]

On the other hand, we have the following cases which apply the general rule and which would deny the taxpayer's contentions here on facts generally more favorable to him than the facts at bar:

In *Dalton* v. *Bowers*, 287 U. S. 404, the taxpayer had for twenty years busied himself with physical research and invention. In a space of five years following 1912 he organized six separate corporations and transferred to each patents for exploitation. The

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[6] The *Giblin* case (Pet. Br. 15-16) was distinguished by the very court which decided it, in *Pokress* v. *Commissioner*, 234 F. 2d 146, 150 (C.A.5th). Other cases cited by the taxpayer (Br. 12, 16) are inapposite. *Spencer* v. *Maloney*, 73 F. Supp. 657 (Ore.), affirmed, 172 F. 2d 638 (C.A.9th), and *Estate of Stokes* v. *Commissioner*, decided November 21, 1951 (1951 P-H T.C. Memorandum Decisions, par. 51,343), affirmed, 200 F. 2d 637 (C.A.3d), were not decided on the "promoter" principle. In *Spencer* v. *Maloney* the trial court found as a fact that money loaned by the taxpayer to two corporations and subsequently lost was lost in the taxpayer's business of leasing plants which he carried on as a sole proprietor. This Court found that finding not clearly erroneous, ruling that the loans were made under a contract which required the taxpayer, as part of his services as landlord, to adequately finance the needs of the lessee-corporations. In the *Stokes* case the Third Circuit agreed with the general principle heretofore discussed; however, it affirmed the Tax Court's finding that the taxpayer was individually engaged in the business of locating promising patents, financing developments, acquiring title to machinery and plants, and securing rights to foreign patents—all substantially prosecuted on the taxpayer's own account. In addition, the taxpayer interested himself in six corporations which helped him expoit his patents. The losses sustained due to loans made to one of those corporations were held incurred in the taxpayer's individual business of exploiting patents.

taxpayer was sole owner and operated and financed these corporations. The Supreme Court refused to allow a business deduction for the loss which the taxpayer incurred on his stock, holding that the facts were not so unusual as to except the taxpayer from the general rule.

In *Burnet* v. *Clark*, 287 U. S. 410, the taxpayer was controlling stockholder and active head of Bowers Southern Dredging Company, a corporation; he also was a member of three partnerships in the same business as the corporation, and he owned stock in a number of corporations. The Court declined to consider guaranties made by the taxpayer for Bowers Southern Dredging Company as part of an individual business of his—holding the facts not so unusual as to except the taxpayer from the general rule.

In *Van Dyke* v. *Commissioner*, 23 B.T.A. 946, affirmed *per curiam*, 63 F. 2d 1020 (C.A.9th), affirmed *per curiam*, 291 U. S. 642, rehearing denied, 291 U. S. 650, the taxpayer was interested in six corporations and promoted and operated at least four of them. He loaned money to these enterprises and sought a business deduction for a loss on loans made to one of the corporations. The taxpayer in that case made the same argument before this Court as the taxpayer here makes—that he was a "promoter", promoting, financing and operating many business enterprises. (See the taxpayer's brief (pp. 7-9, 11-15) in *Van Dyke* v. *Commissioner*, No. 6949 (C.A.9th), in which the petition for review was filed in this Court on March 17, 1932.) This Court affirmed the finding of the Board of Tax Appeals, holding that

the loss was not a business loss, on the authority of *Burnet* v. *Clark*, *supra*, and *Dalton* v. *Bowers*, *supra*, and the Supreme Court affirmed.

In *Towers* v. *Commissioner*, 24 T. C. 199, affirmed, 247 F. 2d 233 (C.A.2d), certiorari denied, January 6, 1958, the taxpayers, during the period 1936 through 1947, organized four corporations and one partnership. They devoted the major portion of their business activities to operating two of the corporations and derived substantially all their income therefrom. On a number of occasion they loaned money to their corporations and in 1947 when the corporations were adjudged bankrupt the taxpayers incurred losses on their loans. The Tax Court's finding (p. 210), that the promotional business ventures were not continuous and unbroken during the entire period 1936 to 1947 and did not, therefore, constitute part of a single overall business, was affirmed by the Second Circuit.

In *Brinker* v. *United States*, 116 F. Supp. 294 (N.D.Cal.), affirmed *per curiam*, 221 F. 2d 478 (C.A.9th), *Wheeler* v. *Commissioner*, decided May 27, 1955 (1955 P-H T.C. Memorandum Decisions, par. 55,138), affirmed, 241 F.2d 883 (C.A.2d), and *Hickerson* v. *Commissioner*, decided December 29, 1954 (1954 P-H T.C.Memorandum Decisions, par. 54,343), affirmed, 229 F. 2d 631 (C.A.2d), this Court and the Second Circuit affirmed trial court findings denying taxpayers business bad debt deductions on facts disclosing more promotional activities than found in the present record. And, see *Schaefer* v. *Commissioner*, 24 T.C. 638, reversed, 240 F. 2d 381 (C.A.2d), where the Tax Court's allowance of a

business bad debt loss deduction to a taxpayer who carried on a movie production and distribution business as officer of four corporations, and who organized and operated two corporations in that field, was reversed by the Court of Appeals.

In considering the taxpayer's arguments, the Tax Court's findings should be examined in the light of the now familiar rule that an income tax deduction is a matter of legislative grace and that the burden of clearly establishing the right to the claimed deduction is upon the taxpayer. *Interstate Transit Lines* v. *Commissioner*, 319 U. S. 590. With this in mind, we submit, it is quite clear that the present case falls within the rule of *Dalton* v. *Bowers* 287 U. S. 404; *Burnet* v. *Clark*, 287 U. S. 410; *Van Dyke* v. *Commissioner*, 23 B.T.A. 946, affirmed *per curiam*, 63 F. 2d 1020 (C.A.9th), affirmed *per curiam*, 291 U.S. 642, rehearing denied, 291 U. S. 650; *Towers* v. *Commissioner*, 24 T. C. 199, affirmed, 247 F. 2d 233 (C.A.2d), certiorari denied, January 6, 1958; *Brinker* v. *United States*, 116 F. Supp. 294 (N.D.Cal.), affirmed *per curiam*, 221 F. 2d 478 (C.A.9th); *Wheeler* v. *Commissioner*, decided May 27, 1955 (1955 P-H T.C. Memorandum Decisions, par. 55,138), affirmed, 241 F. 2d 883 (C.A.2d); *Hickerson* v. *Commissioner*, decided December 29, 1954 (1954 P-H T.C. Memorandum Decisions, par. 54,343), affirmed, 229 F. 2d 631 (C.A. 2d); and *Schaefer* v. *Commissioner*, 24 T. C. 638, reversed, 240 F.2d 381 (C.A.2d); and is clearly not within the ambit of the "promoter" line of cases.

The evidence in the present case discloses that the taxpayer in 1930 organized Pictures, Inc., which re-

mained inactive until 1949. In 1932 he organized Screen Adettes, Inc., the business of which was the sale and distribution of films. The taxpayer was an officer and employee of that corporation, and on several occasions personally guaranteed loans made to it by a bank. (R. 21, 27.) In the subsequent thirteen years the taxpayer's activities were substantially confined to one corporation (Screen Adettes, Inc.), and he engaged in no promotional or organizational activities whatever. (R. 27.) In 1945 he organized Screen Adette Equipment Corporation for the purpose of engaging in the sale and distribution of motion picture equipment and accessories, and he subsequently (in the year 1946) executed a guaranty so that the corporation could obtain loans from a bank, which money was needed in its business. The taxpayer was an officer and employee of that corporation. (R. 27-28, Ex. 8-H.) In the subsequent five years the taxpayer neither organized nor promoted any corporations. (R. 27-29.) He owned controlling shares in Helene's, Inc., a corporation engaged in the ladies' clothing store business, but he did not organize that corporation; he was an officer and employee and guaranteed, prior to 1949, loans made by a bank to that corporation. Helene's, Inc., ceased business in 1949. (R. 29.) In 1949 Screen Adette Equipment Corporation went into bankruptcy and was dissolved in 1950 (R.28), the year in which the taxpayer incurred the losses on his guaranty for that corporation and for which he claims business bad debt loss deductions (R. 29-30).

It is too clear to admit of dispute that the tax-

payer's promotional activities during the period 1930 to 1950 were *not* continuous, unbroken, regular, or numerous; indeed, they were less than those found in the majority of the cases cited in which stockholders were held not to be engaged in a separate business from that of their corporations. The present record, we submit, forecloses any contention that the promotional activities in this case were so unusual as to have become an occupation in their own right. As the Tax Court found (R. 33), the record merely discloses the customary activities of an individual who devotes himself to carrying on business through several corporations. As such, the taxpayer may not, after having chosen the corporate method for ownership and conduct of business, have the production and financing of the corporate business treated as his individual business.[7] *Dalton v. Bowers*, *supra*; *Burnet* v. *Clark*, *supra*; *Van Dyke* v. *Commissioner*, *supra*; *Towers* v. *Commissioner*, *supra*; *Commissioner* v. *Schaefer*, 240 F.2d 381 (C.A.2d); *Hickerson* v. *Commissioner*, *supra*; *Berwind* v. *Commissioner*, 20 T.C. 808, affirmed *per curiam*, 211 F. 2d 575 (C.A.3d);

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[7] Moreover, it is likewise clear that the taxpayer did not consider, nor does the evidence indicate, that his guaranty of loans was to further any independent promoting business that he contends he carried on; the evidence shows (R. 19), as the Tax Court also found (R. 33), that the guaranty was executed to assist the corporation in *its* business of selling motion picture equipment. For this separate and additional reason, the taxpayer must be denied a business bad debt loss deduction. *Brinker* v. *United States*, 116 F.Supp. 294, 298 (N.D.Cal.), affirmed *per curiam*, 221 F. 2d 478 (C.A. 9th); *Wheeler* v. *Commissioner*, 241 F. 2d 883, 884 (C.A.2d).

Commissioner v. *Smith*, 203 F. 2d 310 (C.A.2d), certiorari denied, 346 U. S. 816.

What is even clearer is that the taxpayer was not *carrying on* a "promoter" business in 1950, the year of the loss. See Section 29.23(k)-6 of Treasury Regulations 111, *supra*. In that year he did not carry on any promotional activities, and had not done so since 1945 when he organized one corporation. For the first time, for part of the year 1950, the taxpayer was personally in the business of selling film equipment (as a sole proprietor) (R. 29); there could be no contention, and there is none, that the loss in question was incurred in that business. The taxpayer's other activity in 1950 was as an employee and a stockholder of two corporations which he had organized eighteen and twenty years prior to 1950, and as a salesman for a firm in which he had no proprietary interest. (R. 27, 29.) These activites, as the Tax Court found (R. 34), clearly did not put the taxpayer in the required business of promoting, financing and managing business enterprises. *Fuller* v. *Commissioner*, 21 T.C. 407, 412; *Reilly* v. *Commissioner*, decided January 20, 1955 (1955 P-H T.C. Memorandum Decisions, par. 55,007); *Cochran* v. *Commissioner*, decided March 21, 1955 (1955 P-H T.C. Memorandum Decisions, par. 55,066).

In short, the record fully supports the Tax Court's findings; it certainly does not compel a matter-of-law conclusion the other way so as to justify assailing that court's findings as clearly erroneous.

CONCLUSION

The decision of the Tax Court is correct and should be affirmed.

Respectfully submitted,

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